

DOW THEORY LETTERS INC.

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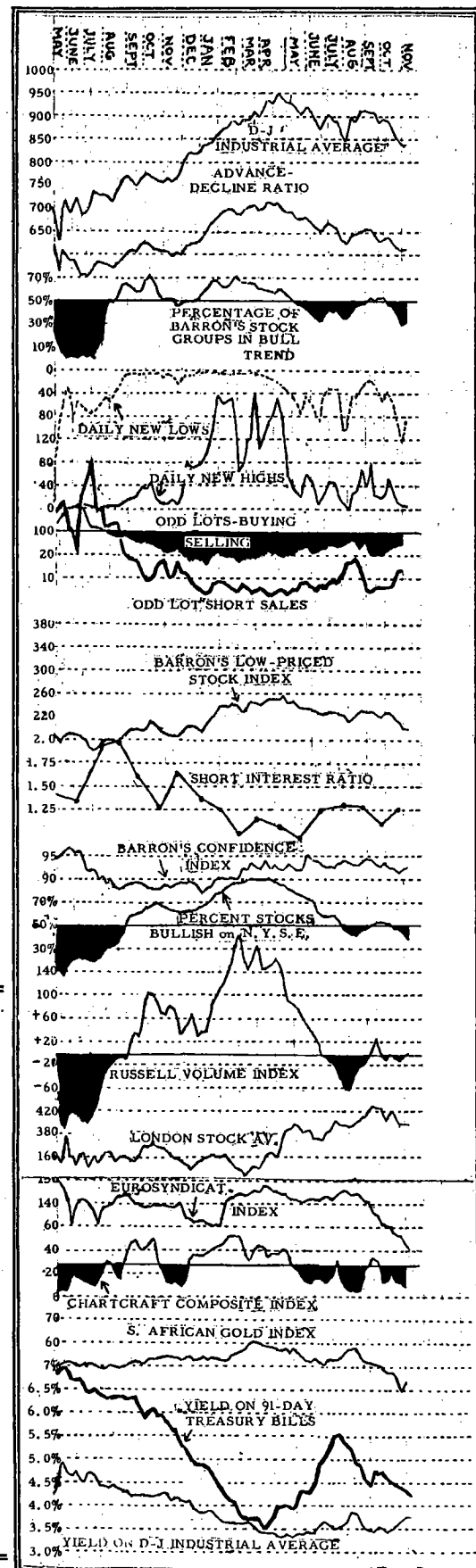
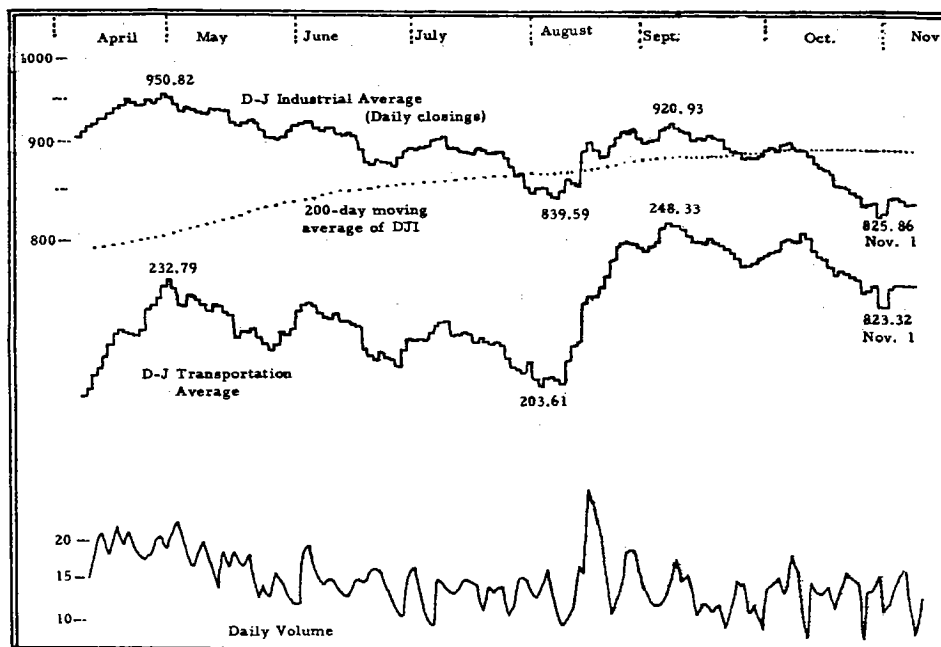
Letter 512

THE PICTURE: Primary bear markets, unfortunately, run on dying bullishness or, to put it another way, on increasing pessimism. In the last Letter I noted that E. George Schaefer, the Dow Theorist from Indianapolis, believes that the underlying force behind this bear market will be "mass disillusionment". I fully agree, and I want to add that disillusionment is a factor which cannot be fed into the econometric models or the analysts' computers. It is interesting to note, however that Louis Harris conducted a poll in 1966 (near the bull market peak) in which, among other questions, he asked which leaders of U.S. institutions you have "a great deal of confidence in". I list the various leaders of institutions below with the 1966 and the later 1971 poll results:

	1966	1971
President	41%	21%
Supreme Court	31%	23%
Organized labor	22%	14%
Banks	67%	36%
Courts	42%	19%
Advertising	21%	13%
Military	62%	27%
Doctors	72%	61%

That seems to be what is happening to America's faith in the men who lead it, and I think such gathering disillusionment is a critical item in the coming storm. In the current (Nov. 15) issue of *Forbes* there appears an article about the U.S.'s failure to continue its technological leadership. It's a fascinating article, and I was just as impressed by an insert by famed historian Lewis Mumford. Mumford states that we have created a generation which will do nothing by manual labor, one that has become so many cogs in a great, impersonal machine. I reproduce Mumford's chilling conclusion on page 2.

Turning to the stock market itself, I simply hate to get too "cute" about exactly what may cause liquidation during the remainder of 1971 and 1972. I agree with



Page 2 Eliot Janeway that "flation" (Eliot's new word) is now coming in. Flation is the divergence between costs, which are continuing to inflate, and prices, which are in the process of deflating. The result — a vicious profit squeeze, one which will become more apparent as we move on, and it is this profit squeeze which the stock market is undoubtedly anticipating now. If there is any doubt about rising costs, those doubts should have been dispelled by the decision of the Pay Board last Monday (indicating that many could get raises far beyond the 5.5% allowed under the guidelines).

Secondly, the international monetary mess is not being taken seriously in this country, but note the new low on the Eurosyndicat Index of 100 leading world corporations (page 1 chart). You might also note that the stock averages of Austria, Belgium, France, Holland and Germany all hit new 1971 lows last week. Watch the multi-national U.S. stocks from here on, the stocks which make their profit "gravy" through their overseas subsidiaries. One highly respected source just wrote me that if there is not some major progress on international monetary affairs by the end of this month, he believes the risks will be inordinately high in the stock market.

As for the current economic "pick-up", here the divergences are as serious as those in the stock market. Last week, despite the "big building boom", Barron's Building & Equipment Group touched a new low for the year. Aluminum, copper, and nickel cut-backs in the face of an auto "boom" are unheard of and absurd, but they are happening. So much for the rosy economic conditions which are supposed to keep this primary bear market from expressing itself.

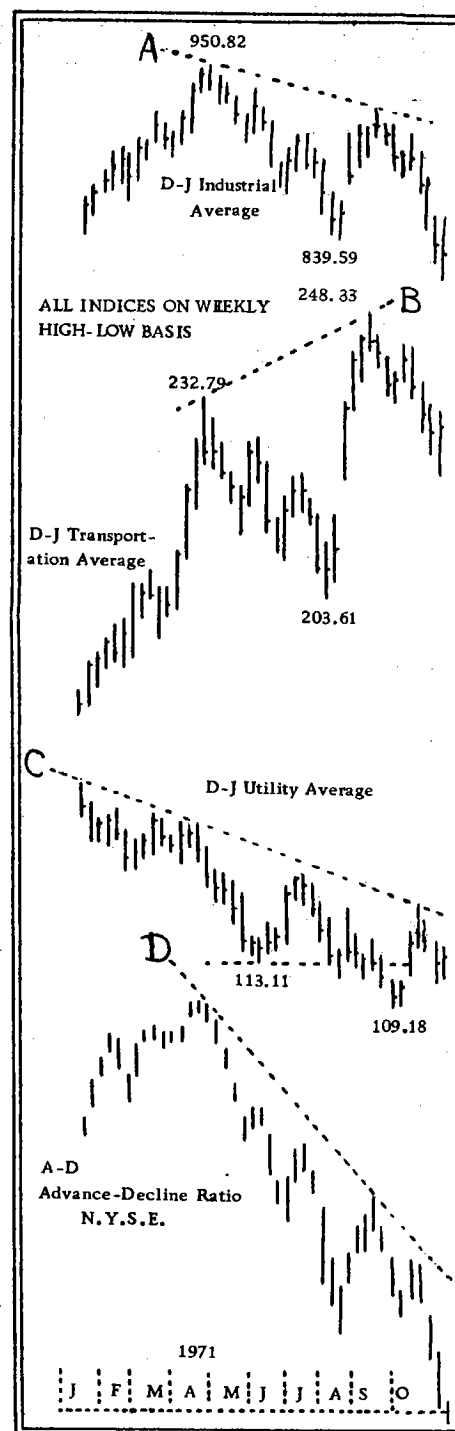
The page 2 chart shows the four indicators we have been following, and only the Transports have been acting as the "glue" which is keeping this market together. The Transports are traditionally the high-leverage, speculative element of the market, and their current strength suggests that the speculators are still hanging on in the vain hope that "a new bull market" started in 1970, and that a quarter of a century of profligacy ended at the 631.16 low of 1970.

I have been pointing to the fact that a huge, unbelievable mass of stock is now "locked in" at high prices (above 880 on the Dow), and that despite a veritable torrent of Government-sponsored "good news reports", the holders of these shares are now sustaining losses. This phenomenon is probably best seen by glancing at the plunging advance-decline ratio at the bottom of the page 2 chart. This ratio takes in the advancing or declining tendencies of all stocks on the N.Y.S.E., and it indicates that 1971 is going down as a costly and bearish year.

Another technical minus appears on the page 3 Merrill Analysis chart (Box 228, Chappaqua, N.Y. 10514), as we see the odd-lot index drop towards buying or to its lowest level since late-1970. Thus the decline from the April, 1971, high (we are now down over 100 points) has succeeded in producing less bearishness on the latest odd-lot reading than at any time during 1971. Hardly a bullish omen for the stock market, particularly since we might have expected a pick-up in odd-lot selling from now on as tax-loss selling comes in. Finally, it should be noted that for the week ending Nov. 5 there were a record-matching 15 secondary distributions, equalling the 15 of the week ending Sept. 24 (see Letter 509 on secondaries). Large interests seem to be more interested than ever in moving out huge blocks of common stock.

Our standard of life, the standard of the rich nations, will have to come down if we're going to lift the standard of life of the rest of the world. We have a standard that you can't establish for the total population of the world, and the notion that we can put it over and make money out of putting it over is an illusion. There are romantic industrial enterprises and financial wizards—men who think they are hard, practical men, who are living in a world of pure illusion. They're the impractical men of today because all the things they do produce the wrong effect. And the long-term effects are increasingly negative.

They talk about benefits: Look at our society. Here's a society that doesn't know how to control the elemental problem of drug addiction and the crime that arises largely out of it. We talk about the benefits we're going to give the rest of the world when we don't dare walk through the streets of New York at night without fear of being mugged. We have a society that is mentally in a state of disintegration and demoralization.



Page 4 If you study this chart, which covers the period from the 1966 bull market top to the present, you will note a number of 1 and 2 and then 3 and 4 signals. One thing worth remembering is that although not every 1 and 2 signal will be followed by a major decline, no major decline can start without a 1 and 2 signal having been given. The same is true of the 3 and 4 signals. In other words, there may be some whip-saws, but these same signals will also identify all of the major moves.

To bring the study up to date, a number 1 sell signal was given in early June, 1971, with the Dow Industrials in the 920 area (see chart). The 4-week MA had done its work and it was then up to the 13-week MA to either plunge below the 50-week MA thereby giving a step 2 sell signal — or to resist. On November 4 the DJI closed at 843.17. This put the 4-week MA at 852 or its lowest point since February, 1971. More importantly, it put the 13-week MA at 882, exactly one point under the 50-week MA of 883. Thus, on November 4, a stage 2 sell signal was given. By this "triple-moving average" system, the stage is now set for a possible major bear market decline. Remember, a stage 2 signal does not guarantee a major decline but every major decline produces a stage 2 signal somewhere near its inception.

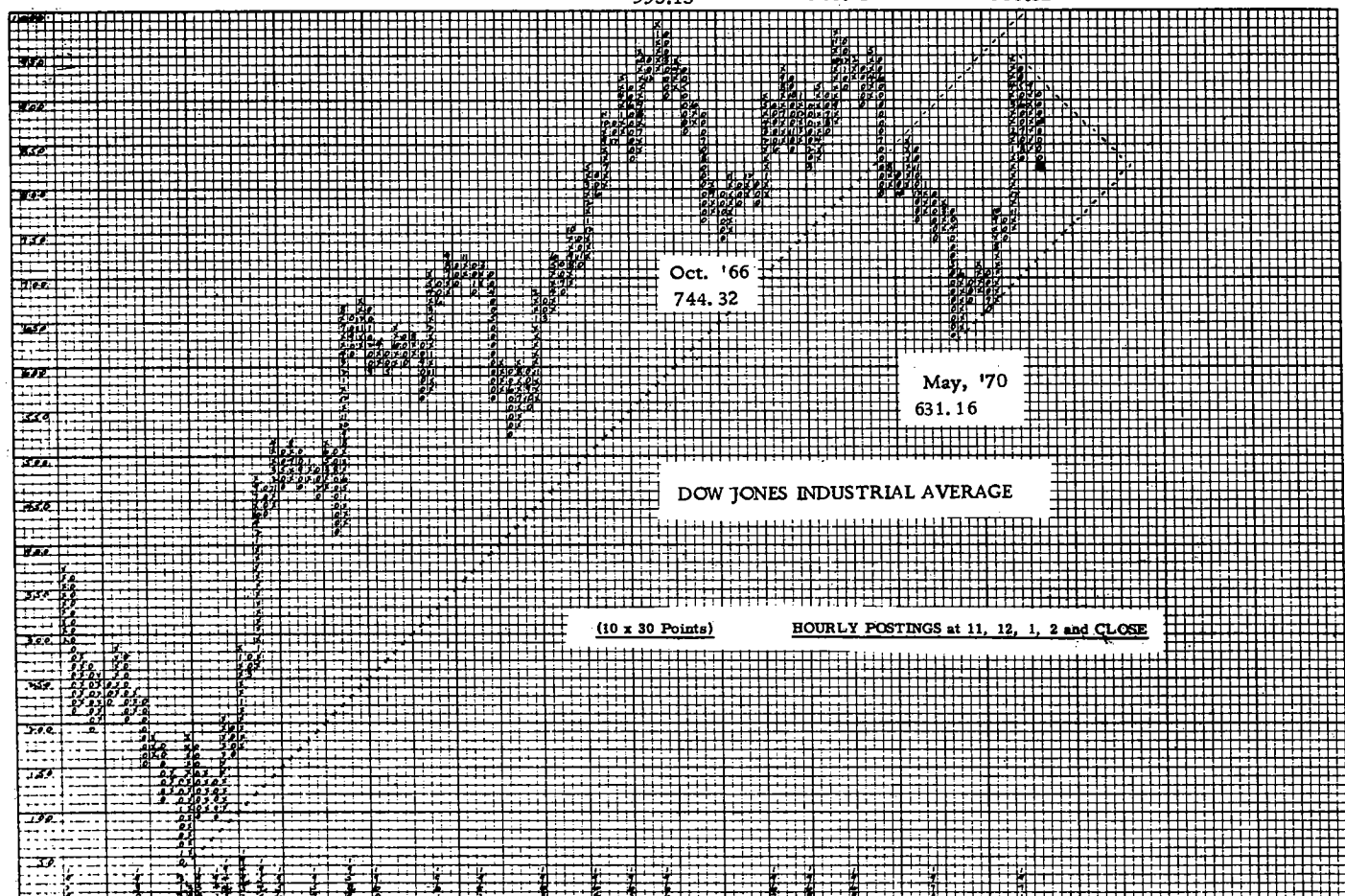
BIG PICTURE: Periodically I include point and figure (P & F) charts as an aid in comprehending the big picture in the stock market. The accompanying chart appears through courtesy of Chartcraft (monthly Chart Book), Larchmont, N.Y. 10538. One of the great uses of P & F charts is that they contain the quality of compression. They compress a great deal of action into a limited space. For instance, this single chart shows all the major action in the Dow from 1929 to date.

Each square on the chart represents 10 points on the Dow, and only rallies or declines of a full 30 points or more are shown (not 29.95 points, but a full 30 points). All the vertical rows of X's depict rallies of 30 points or more, all the vertical rows of O's denote declines of 30 points or more.

Obviously, most of the action of 30 points or more occurred after 1960 (dates are at bottom of chart), since the Dow was then in the above 500 range, and a 30 point movement in the 500's was much more common than a 30 point movement back in the 1920's when 30 points was a much greater percentage move than it would be now.

This is all right, because the main use of this chart, from my standpoint at present, is to show the action since the February, 1966, bull market peak of 995.15 (this is marked at the top of the chart). Note that following the 995.15 peak, there was a

Feb. '66 Dec. '68 Apr. '71
995.15 985.21 950.82



decline to the 1966 low of 744.32, a new bear rally to 985.21 (Dec., 1968), then a crash to the May, 1970, low of 631.16. Finally we have the second major bear rally (1970-71), taking the Dow to the April, 1971, peak of 950.82.

From the April peak the Dow declined to the 840 box (second vertical line consisting of O's), and then a rally took the Dow back to the September, 1971, 920 box (this vertical row consisting of X's). From there, the last row of O's brought the Dow down to the November 1 closing of 825.86, and this is shown as the solid black square at the 830 level (which was the nearest 10-point box).

However, the black square at the 830 level is below the last decline low at the 840 level, and this represents a "sell signal" on this 10-point P & F chart. The Dow is now fluctuating within the confines of a large triangle as shown on the chart. On the downside, it would require a move to 720 to take the Dow below the triangle and provide a second and ominously bearish signal (a signal which would almost surely imply a testing of the 1970 low of 631.16). On the upside, the Dow would have to advance to 930 or better to break out of the triangle and render a "bullish" signal. Until one or the other of these possibilities takes place, the bias should be given to the downside because (1) a bearish signal was given on November 1 with the Dow at 830, and (2) the primary trend of the market is bear, and this is always of overriding importance in drawing inferences about market direction.

NEW GAME: In the last Letter (page 3) I included a chart showing net acquisitions of common stocks by various institutions. Many readers expressed surprise to note that by far the largest purchases came from private pension funds, not mutual funds. The fact is that the pension funds are now "the hottest new game on Wall Street". It is estimated that there is now about \$135 billion in corporate pension funds and another \$100 billion sitting in union, state and city funds. Compare that with around \$55 billion in mutual funds.

Lately, the pension funds in general have been getting "performance" minded. They have been trading in some of their "old fogey" managers for young hot-shots who have been promising them real growth and new investment concepts. It is estimated that about 40% of the \$135 billion corporate pension funds are now in common stock. It is also estimated that in the year ending last June 30, 80% of all new money coming in (and it keeps coming in) to the pension funds went into common stock. For a while earlier this year nearly 100% went into common stock.

What's so exciting about pension funds from Wall Street's standpoint? A great deal: You rarely have to tell the employees what you're doing. You don't have to file reports with the S.E.C. You don't issue daily figures on your worth as the mutual funds do. You don't get net redemptions as the funds do (although net redemptions are something new for the funds). The money keeps rolling in, you don't have to go out and sell the pension fund. Those are just a few of the happy attractions of pension funds.

And Wall Street has been scrambling to get management of those funds. Numerous new firms have been started to take over pension fund management, and the competition gets more intense almost weekly. All of which is worth our considering.

What I have been thinking about is that the pension funds are now loaded with common stock. With 40% of the corporate funds in common, this means that almost half the pension assets are dependent on the stock market. What happens if the bear market starts moving into high gear? What happens if the pension managers suddenly realize that they may have been incompetent blunderers, loading the pension money (which was put aside for millions of employees) in common stock during a major bear market. It seems to me that a turnaround in pension fund psychology could play havoc with Wall Street as billions of dollars in pension fund stocks were dumped during a primary bear market decline. Furthermore, losing an investor's assets in a mutual fund is one thing, but losing an employee's retirement money (pension fund money) is something else again.

It's all food for thought, and I am writing about it because it is on my mind. I feel that the pension funds are acting greedily and without prudence at this time. Later there may be hell to pay.

METALS: The collapse of the metal stocks on the N.Y.S.E. is truly frightening. I include 3 monthly charts on page 6 (the breaks are so bad weekly charts do not begin to show the picture) courtesy of M.C. Horsey, Salisbury, Md. 21801.

United States Steel, the U.S.'s greatest steel producer, has been breaking through support after support ever since 1962. More than two-thirds of the market value of this giant has now disappeared as Steel crumbles to fresh bear market lows.

Alcoa is typical of what has occurred to the Aluminum shares, and here we see mighty Alcoa actually plunging below its 1962 low, to its lowest price since 1955. There's little more to comment on this situation except to say that Alcoa is the U.S.'s major aluminum producer.

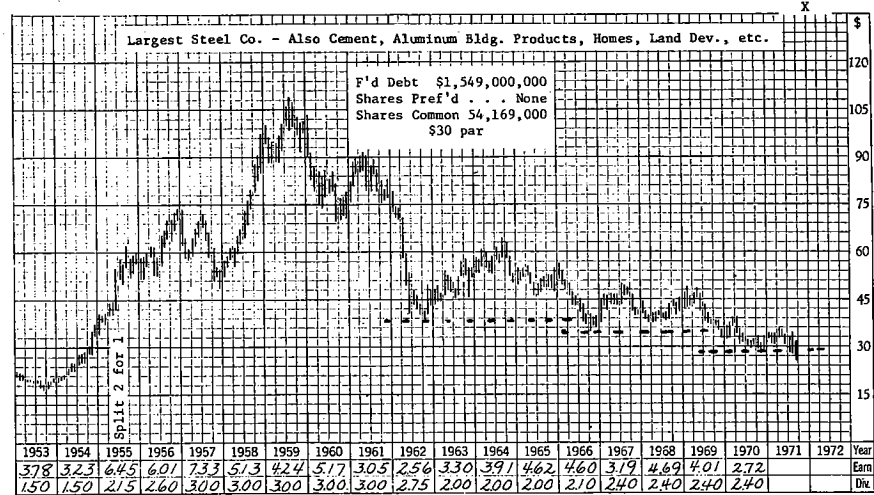
Nickel has broken below a support line (lowest dashed line on chart in the 29 area) which has held for seven years. In his latest report Eliot Janeway notes that Nickel is a commodity which represents the "lowest common denominator of industrial activity". Janeway notes that there has just been a second cut-back in nickel production at Int. Nickel, the second twice as big as the first. This, he feels, is indicative of an international slowdown from Japan to Germany to the U.S. "The nickel trend," states Janeway, "has become unarguable — even though the stock market trend is still subject to argument. It is no longer just trending down — it is collapsing".

LATE NOTES: According to the Washington Post (Nov. 9) Federal Reserve Board Chairman Burns will meet shortly with a group of 25 to 50 brokerage and banking executives in order to try to bolster Wall Street's sagging morale. The idea is supposed to have come from within the White House and reflect the White House's concern with the slumping market.

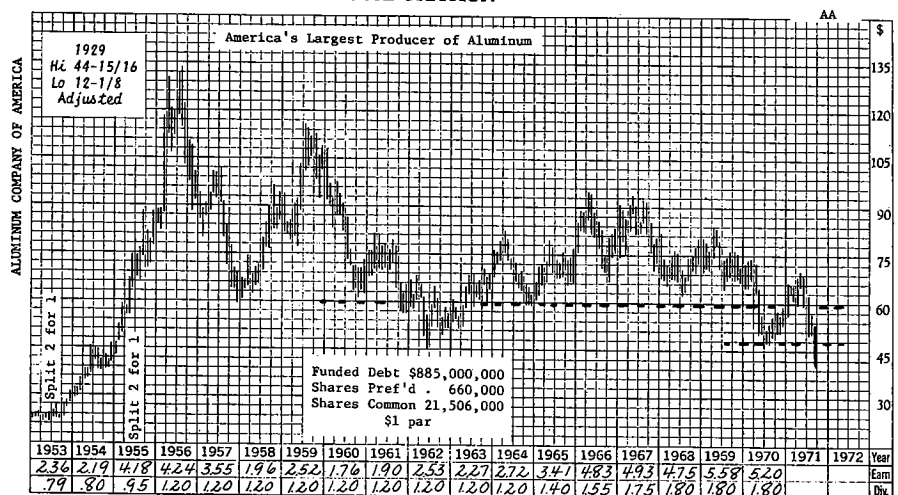
Make no mistake about it, with an election coming up late next year the Administration can be expected to fight this primary bear market tooth and nail. If all the plugs haven't been pulled so far, they will be. But this mighty bear force has been absorbing the frantic efforts out of Washington for the past five years, and in my opinion the market is weaker than ever. But be prepared for all kinds of fireworks, even though I feel that no fireworks of any kind are going to stop the bear.

LATE NOTES: Again, watch the Transports. They are the only indicator resisting on the downside in this market. If the Transports start sliding towards or below 220, then watch out. We will probably wind up with a very, very bad year-end debacle on Wall Street.

UNITED STATES STEEL CORPORATION



ALCOA CORPORATION



INTERNATIONAL NICKEL COMPANY

